An Array of Reinsurance Options to Cover Your Umbrella Exposures—Which Is Right for You?

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Insurers writing Umbrella coverage have numerous choices when it comes to reinsurance of that business. We offer several options, and can share with you the benefits and drawbacks of the different reinsurance structures. There is no right or wrong choice, but each can result in significantly different outcomes, so careful analysis is critical to finding the coverage that is right for you.

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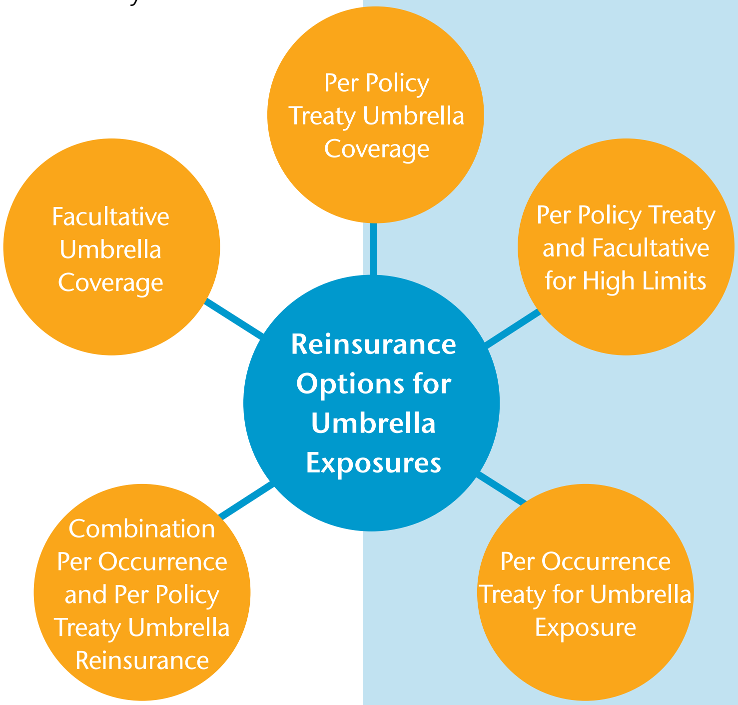
Facultative placements are useful for placing coverage one insured at a time. A Per Occurrence Treaty combines reinsurance coverage with other Casualty lines for a one limit/one retention approach that is experience rated.

Many companies buy a Per Policy Treaty designed to respond to the volatility and severity of Umbrella losses and long tail unknown exposures that could accumulate in an Umbrella book of business. In the Per Policy approach, the limit of reinsurance is not exhausted by a treaty aggregate, and it does not impact the treaty rating for other lines. Each purchasing approach has benefits and drawbacks.



Important Questions

In deciding the appropriate structure and amount of reinsurance for an Umbrella book, companies will likely evaluate a variety of elements, most of which are relevant to any reinsurance decision. We provide several questions for consideration. Your answers can help when it comes to comparing the Per Policy and Per Occurrence Treaty options.

Reinsurance Purchase Considerations

- **Overall Purchase Decision**—Why do you buy Umbrella reinsurance? Solely to protect the balance sheet, avoid volatility, cover unexpected longer-term accumulation risk, gain access to product expertise, protect profit center results, risk management, or some combination of these?
- **Rate and Rate Consistency**—What is the rate or cost of reinsuring your Umbrella business, and will it be affected by loss experience—good or bad?
- **Retained Loss**—How does your reinsurance retention level on your other business compare to your risk appetite and retention on Umbrella? What are the relative Umbrella loss retentions with which your company is comfortable?
- **Other Loss Related Costs**—If an unusual number of claims deplete the limit, are reinstatement costs triggered? Do any experience-related cost adjustments come into play?
- **Loss Limits and Aggregates**—Is there an aggregate limit on your Umbrella reinsurance that caps indemnity for a certain number of occurrences or a certain loss amount?
- **Administrative Costs**—What is the ease of use associated with each structure option, and how does this translate into costs?
- **Product Support**—How important is product expertise on underwriting, risk analysis, pricing, forms and claims? Does the level of product support from marketing to underwriting to claims vary with the reinsurance options and providers?
- **Reinsurance Service**—How important is this service? Does the level of reinsurance service vary with the reinsurance options and providers?

Whether the above features matter or not, consider this test: What would happen under various reinsurance options when a large Umbrella limit loss occurs? What will the quality and expediency of claim assistance and payment, product support and continuity/consistency of reinsurance terms, rates and coverage be?

YOUR COMPARISON CHECKLIST

Criteria to Consider When Choosing a Reinsurance Structure for Umbrella Business

Exposures Reinsured
- ❑ Retention
- ❑ Limits

Cost
- ❑ Initial Rates
- ❑ Reinstatements/Other

Predictability
- ❑ Contract Adjustments
- ❑ Future Contract Adjustments

Consistency
- ❑ Across Lines
- ❑ Within Umbrella

Ease of Use
- ❑ Administration Product Support
- ❑ Rate/Form/Risk Assistance

Reinsurance Support
- ❑ Claims Assistance/ Payment

Corporate Support
- ❑ Other Business Assistance

Per Policy Reinsurance Treaty

Under a Per Policy Treaty, the reinsurance contract is tailored for the unique characteristics of Umbrella risks. The Treaty retention, limit and rate are a reflection of the Umbrella business ceded to the Treaty, and these are not affected by other Casualty business.

- Tailored Umbrella retentions allow insurers to keep or cede more exposure and premium, depending on the insurer's preference, profitability of business and risk appetite.
- Umbrella loss severity and volatility are contained within the Umbrella Treaty and do not affect reinsurance terms for other lines of business.
- The reinsurance limit is based on the Umbrella policy limits exposed in any one occurrence, mitigating the risk of "going through the top" of the cover, or needing additional Treaty layers, or invoking aggregate Treaty limits.
- The occurrence definition follows the definition in the Umbrella policy. This could result in more reinsurance coverage in certain loss scenarios.
- Reinsurance premium tends to be more predictable because it is based on the expected Umbrella loss over time. Compare this to an occurrence Treaty where the rate may be adjusted based on adverse loss experience or where there is potential reinstatement premium. By connecting the Treaty rate to the premium collected by the Umbrella product, the insurer and reinsurer share economic interests in the Umbrella profitability. An Umbrella-only Treaty placed with an Umbrella reinsurance specialist should lead to more reinsurer support on rates, forms, claims and other product needs.

Per Occurrence Reinsurance Treaty

In contrast, a Per Occurrence Treaty combines a variety of insurance products and applies a common set of terms. General Liability, Workers' Compensation, Commercial Auto and *Umbrella* can be covered by one agreement, and a loss under each or many draws from the same occurrence limit and retention.

- One set of coverage terms—a one-size-fits-all approach and a single retention across all lines of business easy to administer for underwriting, accounting and claims
- Consistency and certainty of knowing the maximum retained loss for any one occurrence involving one or more policies or insureds (e.g., clash protection)
- Potential volume cost savings by combining all business into one Treaty
- Up-front discount to Umbrella premium net of ceding commission may lower reinsurance costs, which could vary based on the experience of the Umbrella business
- The possibility of less potential friction over triggers and coverage when a loss involves primary and Umbrella products because they have a single retention applied to the entire loss
- Particular value to large regional carriers with casualty retentions equal to or higher than primary product limits

The "all-in-one" Occurrence Treaty offers ease and consistency, but often at the cost of greater exposure and volatility to the insurer. The tailored Per Policy structure delivers more predictability and product support, but often with more administrative costs. It is impossible to say that one option is always cheaper or easier, or better suited or predictable. The specifics will depend on your book of business and the appetite you have to take risk.

Additional Alternatives

Between the Per Policy and Per Occurrence parts of the reinsurance product spectrum are alternatives that combine features of each. These hybrid covers may be attractive to buyers for cost and structure reasons. For example, an insurer can buy a Per Occurrence Treaty including selected Umbrella exposure and add some level of Per Policy cover that inures to the benefit of the Per Occurrence Treaty. This separate layer of Umbrella policy reinsurance may help the insurer gain product support as well as shock loss protection to the Per Occurrence Treaty, along with some cost savings.

Another alternative is a surplus share-type structure for Umbrella policies where the insurer retains a specific risk amount regardless of limits exposed instead of ceding all policies subject to a single Per Occurrence retention. This may allow the ceding company to retain the most profitable part of the Umbrella book while mitigating the total exposure retained net.

Various Treaty features could be combined with the common structures, such as profit sharing and contingent commissions. The ideal mix of structure and specific features for any company may not be immediately apparent. A reinsurance discussion of structure benefits and drawbacks in the context of your goals and book of business can lead to the best outcome.

MAKING A CHOICE

If you are already writing Umbrella business, you may have one of the Treaty structures outlined here. At the time they were chosen, the pros and cons of your structure were likely considered relative to your risk appetite. Perhaps other options were not considered because you were pleased with your contractual arrangements and your reinsurance partner.

If this overview has piqued an interest in exploring Umbrella reinsurance alternatives, this discussion may be helpful toward understanding the impact of a switch and new Treaty structure. Reinsurance decisions are not easy, but studying options can prepare you to make the most effective choices for your company.

We hope this overview is helpful in thinking through Umbrella reinsurance alternatives.

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